PUBLICATION

Spotlight on SALT: More States Conform to Beneficial Federal Tax Treatment of IC-DISCs

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U.S. exporters meeting a few requirements are able to use the IC-DISC (Interest Charge – Domestic International Sales Corporation) to achieve beneficial federal income tax treatment of their export sales. An IC-DISC is usually established as a commission-based entity and a portion of the U.S. exporter's export sales gross receipts are treated as a commission paid to the IC-DISC. The commission expense is deductible for the exporter, while the commission income of the IC-DISC is not subject to current federal income tax. Annually, up to $10 million of export gross receipts may sit tax-free in the IC-DISC, subject only to an interest charge paid by the exporter (the "IC" in "IC-DISC"). If the IC-DISC's shareholders are individuals (or a pass-through entity owned by individuals), the IC-DISC's export earnings that would otherwise be taxed at top corporate or individual tax rates (39.6 percent or higher) are taxed at the 20 percent qualified dividend tax rate when distributed to shareholders. It is no surprise that IRS statistics showed that IC-DISC tax returns increased from 876 filed in 2005 to 1,917 filed in 2008, and it is not unreasonable to expect that when the IRS updates its statistics that the number of IC-DISC returns has increased since 2008 after the American Taxpayer Relief Act of 2012 made the qualified dividend tax rate permanent at 20 percent.

While a handful of states have conformed to the federal income tax treatment of IC-DISCs and their related exporters and shareholders, many states will treat an IC-DISC as a taxable corporation (e.g., in the Southeast, Alabama, Kentucky, Louisiana, Mississippi and Tennessee). However, changes may be afoot with respect to the state corporate income tax treatment of IC-DISCs.

Recently, Michigan and Virginia have enacted legislation that would conform their state corporate income tax treatment of IC-DISCs to follow the federal income tax treatment. Retroactively effective for tax years beginning after December 31, 2011, Michigan Public Act 15 was enacted on February 25, 2014 and an IC-DISC is now expressly exempt from that state's corporate income tax. Likewise, effective for taxable years beginning on or after January 1, 2014, Virginia legislation (H. 480/S. 515) has been enacted that exempts IC-DISCs from the Virginia corporate income tax.

If you would like to discuss the IC-DISC and whether it might be beneficial for your export sales activities, please contact one of the members of the Firm's Tax Group.